# A Guide to Foreclosure-Related Sales and Verification Procedures

**BY THE RESEARCH COMMITTEE**
**INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS**

*This paper was developed for informational purposes only and does not necessarily represent a policy position of the International Association of Assessing Officers (IAAO). This paper is not an IAAO standard. It was prepared for the benefit of assessment professionals and exposed to the IAAO membership for their review. All comments received were reviewed and in many cases incorporated into this final document. This paper was approved for distribution by the IAAO Executive Board on July 18, 2009. An executive summary of this report is available by request from the IAAO librarian.*

## 1. Introduction

The purpose of this paper is to provide immediate guidance for dealing with foreclosure-related sales. The use of foreclosure-related sales in determining market value is a critical problem facing assessing professionals, tax policy makers, and others. In the past foreclosure-related sales generally were excluded from market modeling, comparable sales analysis, and sales ratio studies because they were typically made under some duress and the volume was usually insignificant. However, conditions in the current market in many areas of the United States and elsewhere are such that it is important to take a closer look at the validity of these sales.

### 1.1 Definition of Foreclosure and Foreclosure-related Sales

A foreclosure is a legal process—not a sale. *Black's Law Dictionary* (Garner 1999, 658) defines foreclosure as:

> *A legal proceeding to terminate a mortgagor's interest in property, instituted by the lender (the mortgagee) either to gain title or to force a sale in order to satisfy the unpaid debt secured by the property.*

A number of different types of sales, collectively known as foreclosure-related sales, can occur during the foreclosure process. Foreclosure-related sales must be carefully examined and evaluated to determine whether they need to be removed from potential use as comparable

The Research Committee of the International Association of Assessing Officers (IAAO) investigates current issues, such as foreclosure valuation, and anticipated topics of concern to the assessment profession. Co-authors of this report were committee chair, William M. Wadsworth, President, Radiant Software, Inc.; and committee members August J. Dettbarn, RMA, Douglas County (KS) Appraiser's Office; Scott G. Winter, RES, Real Property Assessment Supervisor, City of Milwaukee (WI) Assessor's Office; and Gary J. McCabe, CAE, Chief Assessor for the Town of Brookline (MA). Participating as committee members were Colin A. Fraser; Hal Holmquist; Peter Davis; Roland S. Ehm; and Ronald D. Gibbs, CAE, AAS. Mary Odom, IAAO librarian, served as staff liaison.

sales for valuation, and whether they should be included in the pool of sales for computer-assisted mass appraisal (CAMA) or automated valuation model studies and sales ratio analyses.

Many resources exist to assist assessors in understanding the potential impact of foreclosures and foreclosure-related sales. A number of private and governmental sources, including Web sites, track and interpret foreclosure data. For example, extensive data can be found on the Web site of the Federal Reserve Bank of New York, at http://www.newyorkfed.org. Canadian assessors can find more information at Housing Market Forecasts, provided by the National Housing Authority, at http://www.cmhc-schl.gc.ca/en/hoficlincl/homain/foan/index.cfm. The bibliography cites additional resources.

### 1.2 Foreclosure-Related Sales and the Market

When there are a significant number of foreclosure-related sales and few traditional sale transactions, the need to consider foreclosure-related sales is more critical. Their impact can be evaluated by determining whether the following conditions apply:

- Are the foreclosure-related sales affecting the sale prices of typical sales in the area?
- Are the foreclosure-related sales the only properties selling in the area?

These sales may be so numerous that typical traditional sellers in the area are forced to lower sale prices in order to sell their properties. If this is the case, these sales have heavily influenced the market and any foreclosure-related sale that passes the market value test is a candidate for use in appraisal modeling, valuation, and ratio studies.

The commonly accepted definition of market value precludes the use of any sales affected by "undue stimulus." (IAAO 2007) However, when foreclosure-related sales are common, they can represent typical stimuli and should be evaluated as potential market value indicators and for possible consideration in any analysis. Sales verification is the key to determining whether a sale meets the market value test.

When the number of foreclosure-related sales is substantial and significantly affects the market of a particular class or group of properties, assessing officials must determine whether these sales need to be considered for modeling, valuation, or sales ratio analysis. This process must be subject to mass appraisal and assessment guidelines established by the *Uniform Standards of Professional Appraisal Practice* (USPAP) (Appraisal Foundation, updated annually) and to rules and regulations established by state and provincial legislation. Failure to recognize and consider these sales can cause over-valuation.

### 1.3 Adjustment of Foreclosure-Related Sales

It is important to compare sale prices of validated foreclosure-related sales and conventional sales. If, other things are equal (or held constant statistically), foreclosure-related sales occur at a discount, prices paid for such properties can be adjusted to prices paid for conventional sales. The papers by Forgey, Rutherford, and VanBuskirk (1994), Carroll, Clauretie, and Neill (1997), Hardin and Wolverton (1999), and Pathak, Campbell, and Giglio (2009) are examples of empirical studies in this regard.

Additional research is in progress to provide further verifiable data to support adjusting these sales for valuation and ratio studies. One such study examines sales data from the City of Milwaukee, Wisconsin (Winter, Gloudemans, and Almy 2009).

When foreclosure-related sales constitute the preponderance of sales in an area or research shows little difference between them and comparable conventional sales, then validated foreclosure-related sales can be used without adjustment. Other variations in the treatment of foreclosure-related sales (e.g., partial adjustments) are also possible but should be based on market study, consideration of appraisal principles, and coordination between local assessors and oversight agencies.

## 2. Overview of the Real Estate Foreclosure Process

The foreclosure process is controlled by government legislation. (See summary of foreclosure practices, appendixes A and B.) The legal requirements tend to vary widely, for example:

- In the United States, foreclosures typically follow a judicial model, while in Canada, the typical model is non-judicial or administrative.
- Where either option is available, local custom often dictates the process.
- Public notice is required in the United States, while it is not required in Canada.
- The period of the notice varies by state or province.
- The time until the property is either transferred to the lender or auctioned can vary.
- The property may or may not be able to be redeemed.
- There is the possibility of a recapture of any deficiency.
- The sale price in excess of the loan, if any, is distributed.

Most states and provinces permit both judicial (see figure 1) and non-judicial (see figure 2) foreclosure processes. The real estate foreclosure process begins when a borrower or mortgagor defaults on loan or mortgage payments. First, the lender issues a notice of default, which can range from a simple notification to the owner of pending foreclosure actions to a publicly recorded and posted notice of the pending legal action against the property owner. A notice alerts the owner, mortgagor, potential buyers, lenders, and other interested parties of the pending legal action.

In a judicial process, the steps are usually as follows:

- Public notice is required.
- Notice is sent to parties related to the transaction and published according to local law.
- The auction date is set at a formal hearing after the borrower is found to be in default.
- The court issues a judgment, which is the sum of the unpaid loan, interest, and court costs.

In a non-judicial process, the following steps are typical:

- The auction date is set by the mortgagee based on the mortgage contract.
- Notices usually include the foreclosure and auction dates (often the same) and the time and term of the auction.
- The property owner is notified prior to the foreclosure and auction.

The foreclosure auction is the event at which the property is auctioned off to the highest bidder as ordered by the civil judgment against the borrower. The notice of the pending foreclosure auction is published for a specified period prior to the sale. The minimum bid is usually the total of the loan principal, uncollected interest due, and court costs. The lender bids at least the minimum bid to satisfy the judgment. In some cases, the property sells to a third party for more than the judgment. In this case, the lender is paid the judgment, and the previous owner receives the remainder. Upon completion of the redemption period, if any, the successful bidder receives a deed.

After the foreclosure process has been completed, the lender or mortgagee receives the judgment amount, which pays off the loan. Because a judgment is only a piece of paper, the lender is forced to purchase the property at the judgment amount or hope it sells for more than the judgment, thus satisfying the judgment. If the lending institution is the successful bidder, the property becomes a lender asset known as Real Estate Owned (REO) or, in banking regulations, Other Real Estate Owned (OREO) to distinguish these assets from the financial institution building(s).

**Figure 1.** Overview of judicial foreclosure process

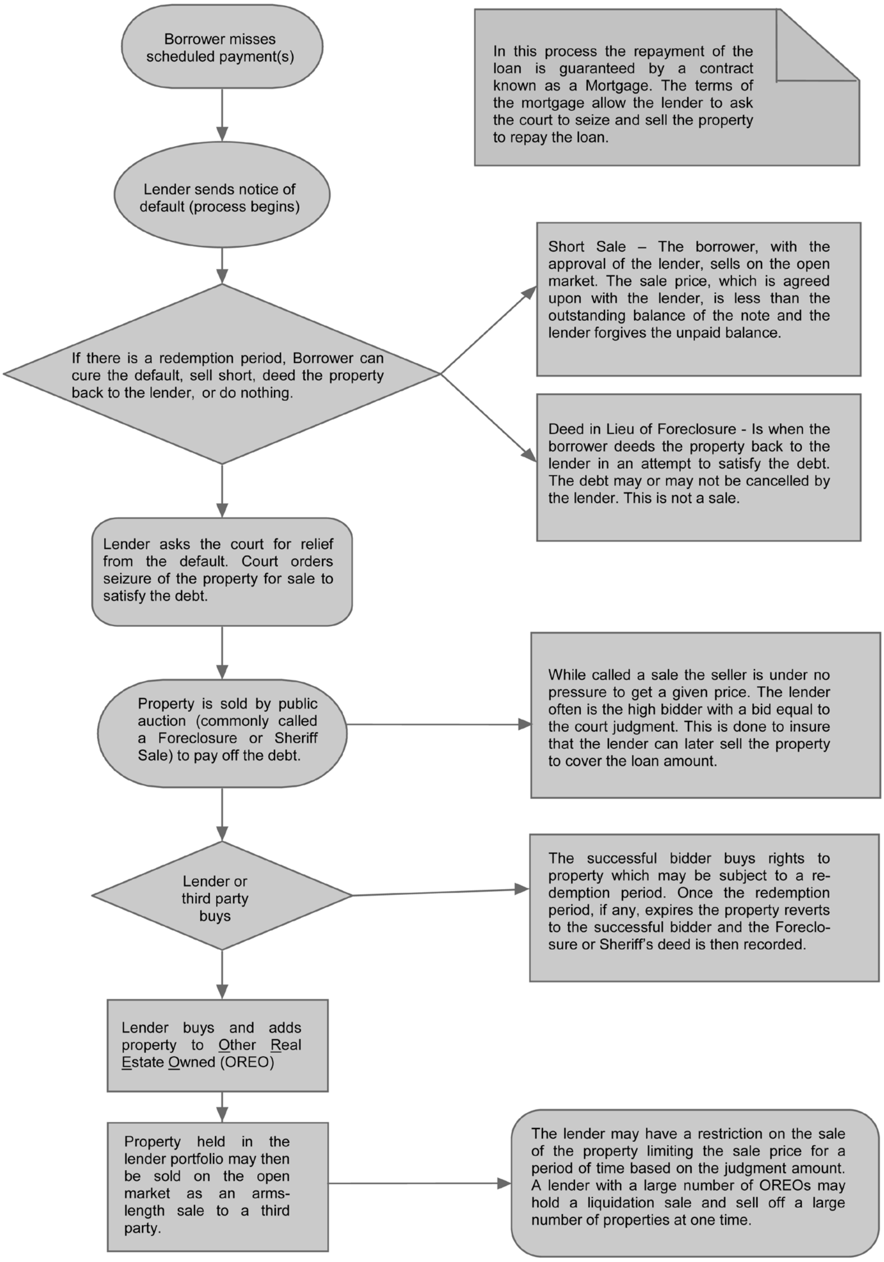
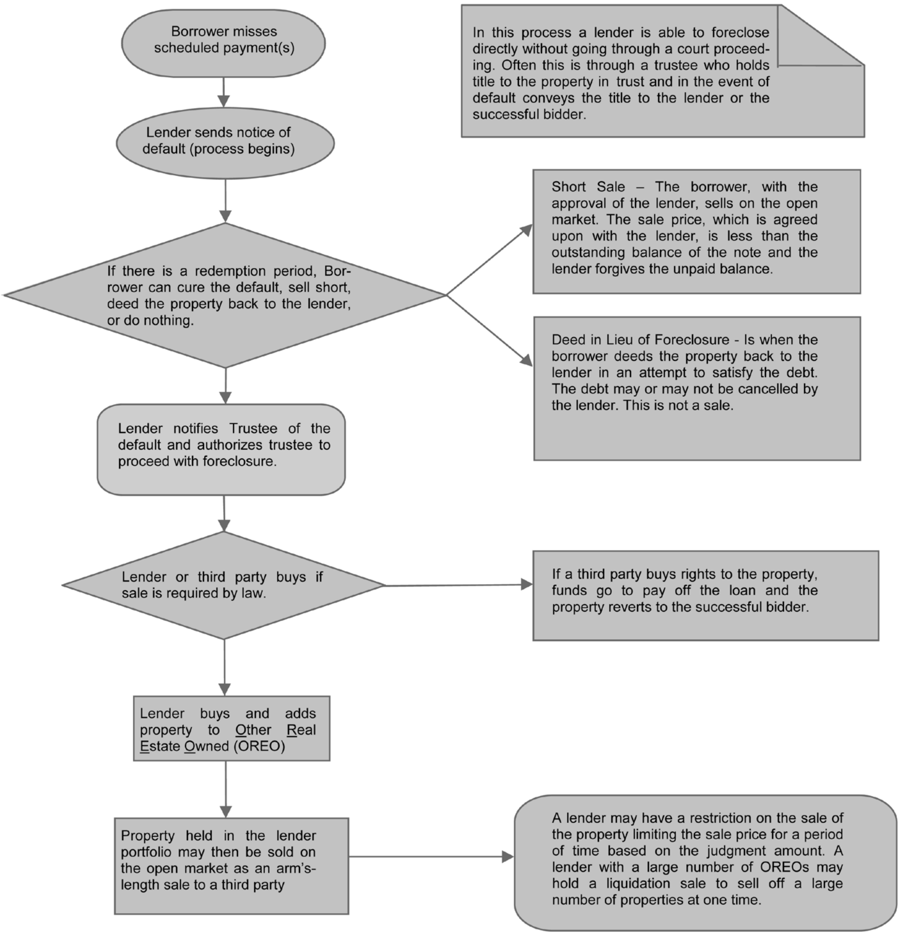


**Figure 2.** Overview of non-judicial foreclosure process




## 3. The Market Value Concept and Definitions of Foreclosure-Related Sales Terms

Determining *market value* is the major focus of most real property appraisal assignments, including mass appraisal projects. For sales, including foreclosure-related sales, to be used for modeling, valuation, or ratio studies, they must first meet the market value test. Both economic and legal definitions of market value have been developed and refined. The IAAO *Standard on Ratio Studies* (2007, 41) provides a definition of market value that is generally accepted by assessors and state-level property tax officials:

> *The most probable price (in terms of money) which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: The buyer and seller are typically motivated; Both parties are well informed or well advised, and acting in what they consider their best interests; A reasonable time is allowed for exposure in the open market; Payment is made in terms of cash or in terms of financial arrangements comparable thereto; The price represents the normal consideration for the property sold unaffected by special or creative financing*

*or sales concessions granted by anyone associated with the sale.*

Although they appear to be excluded from this definition, foreclosure-related sale prices may reflect market value or they may be adjusted for use in modeling, valuation, or ratio studies. Additional verification is necessary, however, to determine whether a foreclosure-related sale could qualify as evidence of market value. All sales are the result of varying amounts of stimuli. Stimuli can be external or internal. The price a buyer is willing to pay for any particular property can be influenced by any number of factors. Therefore the assessor or appraiser should determine and document any indications of undue stimuli and, if possible, make adjustments for potential use in the appraisal and appraisal-monitoring process.

An *arm's-length sale* is "A sale between two unrelated parties, both seeking to maximize their positions from the transaction." (IAAO 2008, 13)

The following sections define key foreclosure-related sale terms.

### 3.1 Pre-foreclosure Sales (Sales to Limit Losses)

Pre-foreclosure sales to limit losses occur prior to the Sheriff's Sale or Administrative Sale. They can be difficult to detect since the financial institution is not listed as party to the transfer. They must be researched to ensure they meet the market value test. Because the financial institution is a silent partner, the amount of stimuli the seller experiences must be very carefully examined during the validation process.

#### *3.1.1 Normal Third-Party Foreclosure-Related Sales*

These are sales in which the loans against the property are in some stage of default and the amount owed is less than the value of the property. These sales typically, but not necessarily, occur before the Sheriff's Sale or Administrative Sale. The parties are selling to avoid a formal foreclosure process and loss of equity and credit standing. These types of sales typically occur through the listing process and can meet the definition of an arm's-length sale if the buyer is not a relative or business associate of the seller. Verification via clerical screening of these sales would not indicate anything out of the norm and the sale would go through the process unnoticed. Therefore, if determined to be a market value transaction, these sales should be included in any sales ratio analysis. They also can be used as part of future revaluation cycles in the calibration of models and in comparable sales analysis.

The following conditions can indicate undue stimuli or duress:

- Indication that there was not a third-party marketing agent (sold by owner)
- Unusually short time on market compared to that for similar property in the same market area
- Property condition issues indicated by "as is" sales or sales with a listing clause concerning buyer's inspection and repairs
- Listings that do not allow any contingencies or require a quick closing date
- Seller relocating to less expensive housing.

If any of these conditions exist, the sale may be excluded from modeling, valuation, or ratio study processes. Even if there is no apparent duress, the sale price should be reviewed against other valid, comparable sales to gauge whether the sale price generally conforms with prices in the market area.

#### *3.1.2 Short Sales*

A short sale is usually a pre-foreclosure sale in which the total sale price is less than the total amount owed against the real estate. The financial institution agrees to forgive a portion of the loan balance and allows a transfer of title to avoid a formal foreclosure. With the permission of the financial institution, the seller finds a third-party buyer and the proceeds of the sale go directly to the financial institution. In some cases, the sale may meet the test for a market value transaction even though the purchase price is less than the outstanding mortgages but not necessarily less than the market value. Short sales are often the result of projections of the future market growth not being realized. This condition has arguably been a root cause of every real-estate-related financial crisis.

In very special conditions, a lender may agree to a post-foreclosure short sale during the redemption period. This is often found with commercial property having tenants in place. In this case, the lender is working to reduce the potential deficiency that occurs when the lender sells the property. The owner who is losing the property as a result of foreclosure waives the right to redeem the property. This then frees the financial institution to immediately have the property off the books and in the hands of a third party.

It is likely that clerical screening of a short sale would not disclose anything out of the ordinary, because the seller named is the owner of record, the buyer named is a third-party buyer other than a lender, and there is no indication of bank or lending institution involvement. Further verification using multiple listing service (MLS) data or interviewing the selling agent could identify a short sale because the listing may include a comment, such as "sale needs third-party approval" or "upon approval from financial institution," indicating that a financial institution is also involved. In addition, the indications of undue stimuli listed in section 3.1.1, Normal Third-Party Foreclosure-Related Sales, should be considered.

Even with this knowledge, the sale qualifier should review the sale price against other valid, comparable sales to gauge whether the sale price generally conforms with prices in the market area.

Short sales that meet the market-value test can be used as part of future revaluation cycles in the calibration of models and in comparable sales analysis.

#### *3.1.3 Deed in Lieu of Foreclosure*

This type of transaction occurs when the mortgagee and the mortgagor have agreed that "in lieu" of being foreclosed upon, the seller will convey the property to the lender by means of a deed or similar instrument of transfer. The property is typically transferred via warranty deed or a quit claim deed, and the total reported purchase price is the amount of the loan in default and may include associated fees. It then becomes the financial institution's property, without the lender having to incur the costs and time associated with going through the foreclosure process. Because the transaction is not exposed to the open market and the reported consideration is predicated on the amount required to satisfy the debt and not on the market value, it should not be used for sales ratio studies, model calibration, or comparable sales analysis. It should show up during the clerical screening as a transfer to a financial institution; this is not a sale.

### 3.2 Pre-foreclosure Sales with Stabilization (Pressured Sales)

Pre-foreclosure with stabilization normally occurs with rental property. The financial institution may request that management of a rental property be changed to increase occupancy and enhance marketability. If the owner honors the request, the financial institution delays the foreclosure process. Once cash flow is stabilized, the property is then sold. This avoids formal foreclosure and reduces the deficit exposure. The sale can be used as part of future valuation cycles in the calibration of models and in comparable sales analysis if the sale price and income and expenses ratios are generally within the range of similar properties in the market area.

### 3.3 Pre-foreclosure Sales to Cure Deficit (Pressured Sales)

If the mortgage covers multiple parcels or a parcel that can be legally divided, the lender may approve a sale of part of the encumbered assets. The proceeds can then be used to cure the deficit on the balance of the loan. This is difficult to detect because, unless the mortgage details are known, it appears as a straight transfer or parcel split. These types of pre-foreclosure sales can be caught during screening by checking to determine whether the parcel has a mortgage release and only part of the mortgage is being released. The sale verification process must try to determine how the sale price was determined. If part of the property was liquidated to raise cash, the sale should be invalidated. However, if the property split went through the typical marketing process and the post-split property was exposed to the open market, the sale could meet the market-value test and then be used as part of future revaluation cycles in the calibration of models and in comparable sales analysis.

### 3.4 Sheriff's Sale or Administrative Sale

In a Sheriff's Sale or Administrative Sale, the property is sold by means of a public auction to the highest bidder. This is done to satisfy either a court order or administrative action. The opening and often the minimum bid amount is set by the amount of the judgment. In many if not most cases, the highest bidder is the financial institution and the bid amount is the sum of the defaulted loan, plus interest and associated fees resulting from a judgment in favor of the financial institution. Even in jurisdictions with a disclosure requirement, no sales instrument may be recorded.

Because the financial institution bids up to the amount of the note plus fees and interest, the sale price could be more or less than current market value. If the property is acquired by a third party, the sale price may be considered valid if the sale is well advertised and well attended and there is a minimum opening bid below which the seller has a right of refusal. The sale verification process must determine whether the pool of buyers (bidders) was sufficient to be deemed an open market. If validated, the sale can be used as part of future revaluation cycles, in the calibration of models, and in comparable sales analysis. Other examples of properties for which the auction could attract market value bidders are projects under construction at the time of foreclosure, property with documented redevelopment potential, and unique or historical property.

### 3.5 Post-foreclosure Sales

#### *3.5.1 Financial Institution Sales*

Regulators separate financial institution properties into two categories in order to more easily differentiate property owned for financial operations from other owned properties: REO and OREO.

*REO* properties are all real property titled to and held by a financial institution. This includes the building(s) housing the institution, lands held for future institutional use, real property acquired by the institution as part of its fiduciary duties, and property acquired as part of debt collection.

*OREO* properties are real properties (including mineral interests) acquired by a financial institution that do not constitute its financial institution facilities. In general, property in the OREO account includes the following:

- Real estate acquired through foreclosure to protect the financial institution's interest in debts previously contracted
- Future expansion properties that have been held more than three years or that are no longer intended for that use
- Employees' residences acquired to facilitate a change-of-duty assignment

- Real estate acquired with the prior written approval of regulators.

OREO properties are normally nonearning assets with values subject to wide fluctuations, which directly affect an institution's financial condition. Consequently, financial institutions make diligent efforts to dispose of OREO properties and maintain documentation adequate to reflect those efforts. The financial institution documentation can be used not only to determine the validity of the sale but also to gain insight into the total inventory of property held in the portfolio, the disposal procedures, and the quantity awaiting future disposal—information that may indicate the direction of the market.

In financial institution sales of OREO properties acquired through foreclosure, the financial institution is listed as the seller. The financial institution may sell these properties on an individual basis or as part of an auction lot (see section 3.5.2, Financial Institution or Bank Auction Sales). Clerical screening would indicate that the seller is a bank or financial institution. In many states, the amount that the lender can sell the property for is limited by the fact that lenders cannot put themselves in a better position than they would have been in if the loan had been paid off. This can lead to an asking price below the market value of the property. Because financial institutions are required to liquidate OREO assets within a relatively short time period or upon reaching a certain percentage of their total assets, there is an astute stimulus to move the property off the books. Most regulators do not require that the property be sold for the highest price nor do they require an independent appraisal be prepared. In many cases, the asking price is set by the broker responsible for handling the listing by means of a Brokers Price Opinion. OREO sales that are determined to meet the market value test can be included in market modeling and ratio studies.

### *3.5.2 Financial Institution or Bank Auction Sales*

Bank auction sales are used by financial institutions to liquidate excess OREO properties. They contain multiple properties that are offered for sale as auction lots at the same time but are not necessarily geographically together. These auctions may have from one to dozens of properties available. The terms could be an absolute auction or a reserved bid.

Typically, these sales are not considered to be an accurate reflection of market value. Because the financial institution is trying to meet regulatory requirements, often it requests a sale at any price or sets the reserve at a level that ensures both attendance and active bidding leading to a sale. However, it is possible for auction sales to reflect typical market prices when many properties in a market area, submarket, or neighborhood are auctioned off. When validating these sales, it is necessary to review the auction procedures. For example, in some cases a group of parcels may be sold as a lot, or auction lot, for a single best bid. This is less likely to be a usable transaction because a purchase price allocation would be required and possibly an adjustment for an auction lot discount.

The IAAO *Standard on Ratio Studies* (2007), section A.4.2.5, Sales with Special Conditions, states:

> *Auctions. In general, auction sales of real estate tend to be at the lower end of the price spectrum. Auction sales that have been well-advertised and well-attended may be valid for consideration in ratio studies. The seller also must have the option to set a minimum bid on the property or the right of refusal on all bids (with reserve) in order for the sale to be considered valid.*

A distinction also needs to be made between typical farm auction or estate auction sales and financial institution or bank auction sales. Farm and estate auction sales tend to be advertised to knowledgeable buyers and sellers. The auction could also possibly involve a real estate broker or agent. Farm auction sales can often be considered market value transactions for modeling, valuation, and ratio studies, while estate auction sales are less likely to qualify as arm's-length sales.

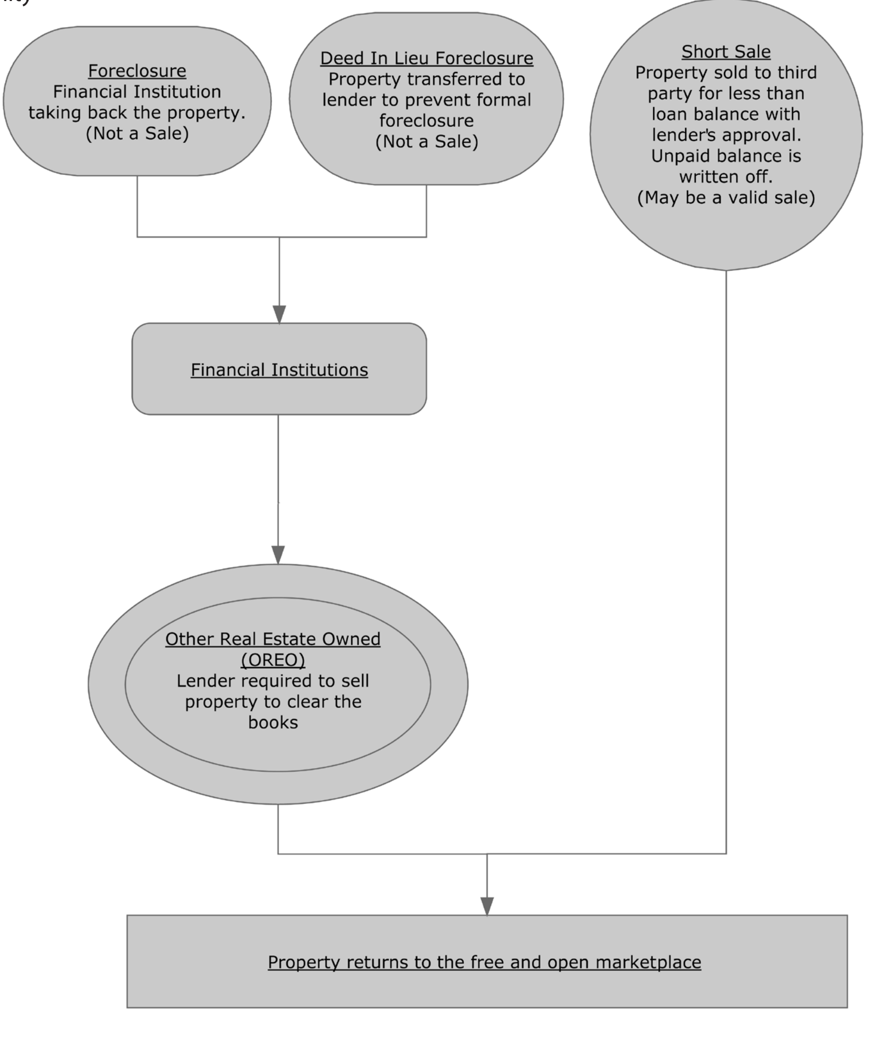
Bank auction sales tend to be similar to any other financial institution sale in which the lender wants to "get the property off its books" and therefore considers all offers regardless of whether they reflect market value. For any auction sale to be considered valid, the transaction should be reviewed by the appraiser to determine whether the sale meets the criteria of an arm's-length sale. In many, if not most, instances, a financial institution or bank auction sale does not meet the arm's-length sale criteria if the seller is being forced to liquidate assets to close an estate or, in the case of OREO property received as part of a loan default, to close out the loan in a condensed time frame.

As a general rule, all financial institution or bank auction sales should be reviewed to determine whether the sale can be considered arm's-length and meet the market value test.

Documentation should be retained that supports the assessor's decision to either use or exclude an auction sale from market modeling or sales ratio studies.

Figure 3 illustrates how each type of foreclosure-related transaction is related to the financial institution.

**Figure 3**. Foreclosure-related terms and transactions and how they relate to the lending community



## 4. Guidelines for the Sales Verification Process

The main purpose of sales verification is to determine whether a sale meets the definition of a market value transaction. Implicit in the definition of market value is the consummation of a sale as of a specified date and the passing of title from seller to buyer under the following conditions:

- The buyer and seller are typically motivated.
- Both parties are well-informed or well-advised and acting in what they consider their best interests.
- A reasonable time is allowed for exposure in the open market.
- Payment is made in terms of cash or in terms of financial arrangements comparable thereto.
- The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

### 4.1 Overview of the Sales Verification Process

A sales verification process is required to determine whether to include foreclosure-related sales in modeling, valuation, or ratio studies.

Many foreclosure-related transactions can be eliminated early in the verification process. It is expedient to filter out those sales that are known to be non-market value before parties involved in the sale are contacted. This filtering can be done on a mass basis by computer or by clerical staff. Mass screening may be more practical with large sample sizes and involves review of the transfer instruments and elimination of any obvious non-arm's-length sales. Mass screening techniques include computer-assisted analyses that can distinguish sales of property in typical conditions at representative prices from sales of property in abnormally poor condition or otherwise out of the normal price range in a given market area. Mass screening can also include electronic identification of and exclusion of certain deed types. Statistical trimming of ratios is also common in larger jurisdictions. If available, MLS data in which foreclosure-related sales and property condition at the time of sale can be discerned are very useful.

According to the IAAO *Standard on Ratio Studies* (2007, 49):

> *The following types of sales are often found to be invalid for ratio studies and can be automatically excluded unless a larger sample size is needed and further research is conducted to determine that sales are open-market transactions.*
>
> 1. *Sales involving government agencies and public utilities. Such sales can involve an element of compulsion and often occur at prices higher than would otherwise be expected.*
> 2. *Sales involving charitable, religious, or educational institutions. A sale to such an organization can involve an element of philanthropy, and a sale by such an organization can involve a nominal consideration or restrictive covenants.*
> 3. *Sales involving financial institutions. A sale in which the lien holder is the buyer can be in lieu of a foreclosure or a judgment and the sale price can equal the loan balance only.*
> 4. *Sales between relatives or corporate affiliates. Sales between relatives are usually non-open-market transactions and tend to occur at prices lower than would otherwise be expected.*
> 5. *Sales settling an estate. A conveyance by an executor or trustee under powers granted in a will may not repre-*

*sent fair market value, particularly if the sale takes place soon after the will has been filed and admitted to probate in order to satisfy the decedent's debts or the wishes of an heir.*

6. *Forced sales. Such sales include those resulting from a judicial order. The seller in such cases is usually a sheriff, receiver, or other court officer.*
7. *Sales of doubtful title. Sales in which title is in doubt tend to be below market value. When a sale is made on other than a warranty deed, there is a question of whether the title is merchantable. Quit claim deeds and trustees' deeds are examples.*

Within distressed market areas with a preponderance of foreclosure-related sales, a larger sample size is needed and further research should be conducted on sales involving financial institutions to determine whether foreclosure-related sales meet the market value criteria.

Ideally, all the sales remaining after the initial filtering process should be examined through an individual sales verification process that includes contacting parties involved in the transaction, typically the buyer and broker/agent, and asking a series of questions to determine whether the sale meets the market value criteria.

Transactions during the foreclosure process that do not meet the definition of market value need to be omitted from the market modeling process, valid comparable sales lists, and sales ratio analysis. Those transfers that do meet the definition of market value should be included in the market-modeling process, valid comparable sales lists, and sales ratio analysis.

### 4.2 Suggestions for Other Verification Sources

Many states and provinces require real estate agents or other parties to the transaction, such as conveying attorneys, to file a sales verification form with the recordation, registration, or assessment office. This practice should be encouraged because it provides a discovery tool for sales verification. Where they are available, these forms should be carefully examined in order to determine whether a sale can be used for modeling, valuation, or sales ratio analysis.

In addition to the sales verification form, the parties to the sale transaction are a good source of information, but interviewing them is not always possible because of limited time and staff resources. Interviews can be difficult because disclosure of financial information is not always possible for the parties involved. Requesting a personal meeting and on-site inspection of the property would provide an opportunity to discuss the terms and conditions of the sale with a knowledgeable party as well as to verify physical data and is therefore recommended.

Other credible sources, such as the following, should be contacted, if necessary.

- *Lenders.* Some of the information helpful in evaluating the potential use of foreclosure-related sales is best obtained from lenders. An ongoing relationship with local lenders provides not only valuable information on foreclosure-related sales but also more recent information than can be gained from published sources.
- *Utility companies or government utilities.* Utility companies and government utilities should have records of properties that have turned off their services. The physical condition of an abandoned property can deteriorate quickly, so identifying a date of vacancy could be helpful in updating assessment records.
- *Code and law enforcement agencies.* Code enforcement agencies receive complaints about many problem properties that are not

being maintained. Their field staff can also be a good source of information on the physical condition of the properties. Police agency reports of vandalism may be another good source of information on property condition or the need for further verification.

- *Volunteer services.* Volunteer services may be able to provide useful information about foreclosure-related sales. These services include neighborhood watch groups, delivery services such as meals-on-wheels, religious missionary organizations, and various other local providers.

## 4.3 Other Verification Issues

### *4.3.1 Physical Condition*

The physical condition and other property characteristics at the time of sale should be determined and compared to the condition on the assessment date; significant differences in physical condition between the two dates would prevent the sale from being used in ratio studies, but could still allow the sale to be considered for valuation and modeling. The IAAO *Standard on Ratio Studies* (2007, 24) states,

> *…physical characteristics of the property on the date of assessment must be the same as those on the date of sale. Properties with significant differences in these factors should be excluded from the ratio study.*

This is particularly critical in foreclosure-related transactions because of the possible change in physical condition due to vacancy of the structure at the time of sale. Properties that are significantly damaged or stripped of mechanicals and other valuables should be excluded from the market value transaction list.

### *4.3.2 Time on the Market*

The amount of time the property is listed for sale should be considered. A sale is more likely to be market value if the time on the market is long enough to truly be exposed to all market participants. This can be determined by comparing the marketing time of the subject sale with the marketing time typical for the market area at the time of sale. Extra vigilance is necessary in this analysis. Time on the market can be misleading based on relistings. Short market time compared to typical market exposure may be a sign of undue duress. Any review of sales must also consider that other factors, such as a reasonable asking price and the desirability of the property, can influence how long a property is on the market.

### *4.3.3 Number and Percentage of Foreclosure-Related Sales in the Market Area*

Each market area should be analyzed to determine whether there are a substantial percentage of foreclosure-related sales. Foreclosure-related transactions can become so prevalent in some neighborhoods that they strongly influence the market. The principle of substitution states that, "A prudent buyer will pay no more for a property than the purchase price of a similar and equally desirable one." (IAAO 1990, 44) Market asking prices and sale prices are set with this principle in mind. To exclude all foreclosure-related sales from valuation models could result in assessed values that exceed asking prices of non-distressed properties.

## 4.4 Documentation of the Verification Process and Results

Comprehensive documentation of the process and results of the foreclosure-related sales verification effort is important to support decisions for both valuation modeling and ratio study purposes. No substantive questions should remain unanswered. Documentation of the process should take place at the time of verification, and the results should be reported as part of the mass appraisal or reassessment program. The validity of all sales used must be supported through review documentation.

A sales verification form or set of interview questions should seek to clarify a number of key foreclosure-related sale issues, such as the following:

- What was the total mortgage or loan balance?
- What was the asking price?
- What was the sale price?
- Was personal property involved, and if so, what was its value?
- Was an independent appraisal performed, and what was the value?
- What was the condition of the property at the time of sale, and have any changes in condition or other property characteristics occurred since?
- Was there any indication of fraud?
- How was the property marketed (i.e., listed with a real estate agency, word-of-mouth, newspaper, for-sale signs, Internet, auction, and so on)?
- How long was the property exposed to the open market?

Other key features on a verification form are as follows:

- Parcel identification number of the property that sold
- Sales disclosure document number
- Name, telephone number, and other contact information of parties to the transaction
- An information source code that can be queried
- A validity decision code that can be queried.

### 5. Written Guidelines and Training

A comprehensive set of written guidelines along with specialized training should be provided to staff in charge of validating and screening foreclosure-related sales.

For CAMA systems and ratio study programs, specific codes can be assigned to sales to clearly identify foreclosure-related sales, providing the flexibility to add or extract the data for future analysis. Assigning different codes for different types of foreclosure-related sales affords the user more flexibility in reporting and analyzing data.

### 6. Sales Information Disclosure

Many states and provinces currently have laws mandating sale price disclosure, that is, a sales verification form or other document must be filed with the recordation, registration, or assessment office. Currently the number of U.S. states with some type of sale price disclosure requirement is 36, and only 10 of those states use a questionnaire (Technical Standards Committee 2009). IAAO strongly encourages jurisdictions that do not currently have mandatory sale price disclosure and a requirement for a comprehensive sales verification form to actively seek such authority. Without this information, assessing officials continue to work under difficult discovery conditions.

### 7. Monitoring and Communication

Monitoring foreclosure trends makes it possible for jurisdictions to be more proactive in tracking and responding to changes in foreclosure activity. Assessing officers are encouraged to report increased activity to other governmental agencies in anticipation of the effects of a changing market and housing-related issues. Public relations programs may need to be prepared and initiated or current ones altered. For more information on this topic, see the *Standard on Public Relations* (IAAO 2001).

Regardless of assessed value changes made in consideration of foreclosures, property tax changes cannot be anticipated without a complete understanding of the underlying assessment and property tax systems (see *Standard on Property Tax Policy* [IAAO 2004]).

## 8. Measuring Dispersion

In cases in which the typical market sales have not yet responded to the influence of foreclosure-related sales, a price gap is created and the coefficient of dispersion parameters recommended by the IAAO *Standard on Ratio Studies* (2007) may not be met. As a result, jurisdictions can fall out of assessment uniformity compliance. Oversight agencies and assessors should be prepared for this possibility and may either accept less precision or change the sample size.

## 9. Oversight Agencies

Oversight agencies must work closely with local jurisdictions to ensure that only valid foreclosure-related sales are considered. As part of the official ratio study conducted by the oversight agency, an informal appeal process should be developed for the consideration of these sales when *verifiable* documentation is provided by the local jurisdiction that such sales are truly influencing the market in any specific area of the jurisdiction. This process is especially important when the oversight agency performs an independent validation process. (See the *Standard on Administration of Monitoring and Compliance Responsibilities*, section 10, Performance Evaluation [IAAO 2003].)

## 10. Conclusion

The recent large increase in foreclosures has resulted in renewed interest in evaluating foreclosure-related sales for modeling, valuation, and sales ratio analysis. There are two ways in which foreclosure-related sales can be used.

First, there may be sufficient foreclosure-related sales in a market area such that they no longer represent *undue stimulus* and therefore may meet the market value test. They may force all sellers in a market area to discount their property in order to compete.

Second, it may be possible to determine the discount between traditional market value sales and foreclosure-related sales so the foreclosure-related sales can be adjusted and used in valuation modeling, as comparable sales, and in ratio studies. Several papers that describe how foreclosure-related sales might be adjusted are cited here. In addition, IAAO and others are working on case studies and research to determine how foreclosure-related sales might be adjusted and used.

As with any other sale, it is critical for foreclosure-related sales to be properly verified to determine which, if any, can be used in modeling, valuation, or ratio studies. The special conditions of foreclosure-related sales require that additional information be collected and reviewed in the sales verification process before they can be used. Therefore, IAAO should update the current *Standard on Ratio Studies* (IAAO 2007) to include sales verification or develop a separate Standard on Sales Verification.

Assessors might be able to provide tax policy officials with data so that they can more proactively deal with the economic and financial impact of large changes in the number of foreclosures and foreclosure-related sales. However, the private nature of the early stages of the current foreclosure process makes it difficult for the assessor to get in front of rapid changes in the number of foreclosures and foreclosure-related sales.

Inspecting sale properties for condition at the time of sale is not as critical in typical sales. However, stripping and vandalism appear to be more prevalent among foreclosure-related sales. Therefore, a determination of the condition of the property is a critical element of the verification process. Assessors may need to use non-traditional methods of discovery and data collection to verify condition.

Collecting the additional information required to verify foreclosure-related sales, including determining their condition at the time of sale and the additional information required to proactively deal with a significant increase in foreclosure-related sales, may dictate the need for additional staff resources and research efforts. The fair and equitable assessment of all property based on market value standards must be supported by agencies at all levels of government. The integrity of assessment systems must be maintained because the property tax is a principal source of revenue for local government.

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# *Appendix A. Summary of Foreclosure Practices in the United States*

| State | Security Instrument | Done through Court System | Non-Judicial | Public Notice | Time Frame | Redemption Period | Deficiency Recapture |
|---|---|---|---|---|---|---|---|
| | The type of document (either a Mortgage or a Trust Deed) used to secure the debt on a real property | A foreclosure process in which the lender must file a lawsuit against the borrower to obtain a court order to foreclose on a Mortgage or Deed of Trust | A foreclosure process in which a third party has the power of sale to foreclose on a Trust Deed document, through public notices | The first type of document that must be made public by the foreclosing lender to start the foreclosure process | The amount of time from the first public foreclosure notice until the property goes to sale at public auction | Where available, the amount of time the owner has to redeem (purchase) the property after it was sold at public auction | When available, the lender (or borrower) may have the right to file a lawsuit and receive a judgment if there was a loss of money from the public auction sale |
| Alabama | Mortgage / Trust Deed | Yes (Rare) | Yes | Publication | 30–60 days | Yes, 12 months | Allowed |
| Alaska | Trust Deed / Mortgage | Yes | Yes | Notice of Default | 90 days | Non-judicial foreclosure only | Judicial foreclosure only |
| Arizona | Trust Deed / Mortgage | Sometimes | Yes | Notice of Sale | 90 days | No | Varies |
| Arkansas | Mortgage / Trust Deed | Yes | Yes | Complaint | 120 days | Judicial foreclosure only (ends at sale) | Non-judicial foreclosure only |
| California | Trust Deed | Sometimes | Yes | Notice of Default | 111 days or more | Yes, judicial foreclosure only | Yes, judicial foreclosure only |
| Colorado | Trust Deed / Mortgage | Yes | Yes | Notice of Default | 110–125 days | None | Yes |
| Connecticut | Mortgage | Yes | No | Complaint | 60–150 days | Court's discretion | Yes |
| Delaware | Mortgage | Yes | No | Complaint | 90 days | No | No |
| District of Columbia | Trust Deed | No | Yes | Notice of Default | 60 days | No | Yes |
| Florida | Mortgage | Yes | No | Complaint | 180 days | Yes, brief and subject to court procedure | Yes |
| Georgia | Security Deed / Mortgage | Yes | Yes | Publication | 90 days | Yes | Yes |
| Hawaii | Mortgage / Trust Deed | Yes | Yes | Publication | 160–195 days | No | Yes |
| Idaho | Trust Deed | No | Yes | Notice of Default | 150 days | Yes | Yes |
| Illinois | Mortgage | Yes | No | Complaint | 210 days | Yes, limited | Varies |
| Indiana | Mortgage | Yes | No | Complaint | 150 days | Yes, 3 months | Yes |
| Iowa | Mortgage | Yes | No, but deed in lieu permitted | Petition | 160 days | No | No |
| Kansas | Mortgage | Yes | No | Complaint | 120 days | Yes, 6–12 months | Yes |
| Kentucky | Mortgage | Yes | No | Complaint | 147 days | Yes | Yes, with restrictions |
| Louisiana | Mortgage | Yes | No | Petition | 60 days | No | Yes |
| Maine | Mortgage | Yes | No | Complaint | 90–365 days (depends on mortgage date) | Yes | Yes |
| Maryland | Trust Deed / Mortgage | Yes | Yes | Notice | 90 days | No | Yes |
| Massachusetts | Mortgage / Trust Deed | Yes | Yes | Complaint | 90 days | Yes, in foreclosure by possession | No |
| Michigan | Mortgage / Trust Deed | Yes | Yes | Publication | 60 days | Yes, 6 months (30 days if abandoned) | Varies, case by case |
| Minnesota | Mortgage / Trust Deed | Yes | Yes | Publication | 60 days | Yes, 6–12 months (35 days if abandoned/ vacant) | Yes |
| Mississippi | Trust Deed / Mortgage | Yes | Yes | Publication | 60 days | No | No |

| State | Security Instrument | Done through Court System | Non-Judicial | Public Notice | Time Frame | Redemption Period | Deficiency Recapture |
|---|---|---|---|---|---|---|---|
| Missouri | Trust Deed / Mortgage | Yes | Yes | Publication | 60 days | Yes | No |
| Montana | Trust Deed / Mortgage | Yes | Yes | Notice | 150 days | No | Judicial foreclosure only |
| Nebraska | Mortgage | Yes | Yes | Petition | 180 days | None, after confirmation of sale | No |
| Nevada | Trust Deed / Mortgage | Sometimes | Yes | Notice of Default | 60–120 days | Judicial foreclosure only | Yes |
| New Hampshire | Mortgage / Trust Deed | Yes | Yes | Notice of Sale | 60 days | No | Yes |
| New Jersey | Mortgage | Yes | No | Complaint | 90–120 days, unless contested | Yes, limited—10 days | Yes, restricted |
| New Mexico | Mortgage | Yes | No, except commercial properties | Complaint | 120 days | Yes | Yes |
| New York | Mortgage / Trust Deed | Yes | Yes, but not common | Complaint | 12–19 months | No | Yes |
| North Carolina | Trust Deed / Mortgage | Yes | Yes | Notice Hearing | 60 days | Yes | Varies case by case |
| North Dakota | Mortgage | Yes | No | Complaint | 90 days | Yes, 60 days–12 months | Yes |
| Ohio | Mortgage | Yes | No | Complaint | 150 days | Yes | Yes |
| Oklahoma | Mortgage / Trust Deed | Yes | Yes | Complaint | 90 days | None, upon confirmation of sale | Yes, with filing time limitation |
| Oregon | Trust Deed / Mortgage | Yes | Yes | Notice of Default | 120–180 days | Yes, but only with judicial foreclosure | Yes, but only with judicial foreclosure |
| Pennsylvania | Mortgage | Yes | No | Complaint | 90 days | No | Yes |
| Rhode Island | Mortgage / Trust Deed | Yes | Yes | Publication | 60 days | Varies by process | Yes |
| South Carolina | Mortgage | Yes | No | Complaint | Varies | No | Yes |
| South Dakota | Mortgage / Trust Deed | Yes | Yes | Complaint | 90 days | Yes, but various time periods | Varies on case-by-case basis |
| Tennessee | Trust Deed / Mortgage | Yes | Yes | Publication | 60 days | Yes, non-judicial foreclosure | Yes |
| Texas | Trust Deed / Mortgage | Yes | Yes | Publication | 60 days | No | Yes |
| Utah | Trust Deed / Mortgage | Yes | Yes | Notice of Default | Varies | Yes | Yes |
| Vermont | Mortgage / Trust Deed | Yes, in strict foreclosure | Yes | Complaint | 210 days | Yes | Yes |
| Virginia | Trust Deed / Mortgage | Yes | Yes | Publication | 60 days | Varies | Yes |
| Washington | Trust Deed / Mortgage | Yes, but not common | Yes | Notice of Default | Varies (190 days) | Available only in judicial foreclosure, and very rare | Yes, but only in judicial foreclosure |
| West Virginia | Trust Deed / Mortgage | Yes | Yes | Publication | 60 days | No | No |
| Wisconsin | Mortgage / Trust Deed | Yes | Yes | Complaint | Varies (90 days–12 months) | Yes, if no court confirmation of sale | Yes, unless waived |
| Wyoming | Mortgage / Trust Deed | Yes | Yes | Publication | 90 days | Yes, 3 months | Yes |

*Source: various Internet sites and the Kansas University Law Library; accuracy and completeness cannot be guaranteed.*

# *Appendix B. Summary of Foreclosure Practices in Canadian Provinces*

| Province | Security Instrument or Governing Law | Judicial Sale | Non-Judicial | First Action | Time Frame | Redemption Period | Deficiency Judgment |
|---|---|---|---|---|---|---|---|
| | The type of document (either a Mortgage or a Trust Deed) used to secure the debt on a real property | A foreclosure process in which the lender must apply to the court for permission and the sale is court supervised and under court authority | A Power of Sale allows the property to sell without court involvement from the mortgage document and/or provincial legislation | The way in which the process is started | The amount of time from the first public foreclosure notice until the property goes to sale at public auction | Where available, the amount of time the owner has to redeem (purchase) the property after it was sold at public auction | When available, the lender (or borrower) may have the right to file a lawsuit and receive a judgment if there was a loss of money from the public auction sale |
| Alberta | Land Titles Act Mortgage or Equitable Mortgage | Primary | | Lawsuit filed against owner | | | Starts as part of the main action |
| British Columbia | | Primary | | Demand letter to borrower | | Traditionally 6 months | Starts as part of the main action |
| Manitoba | | Primary | | Registration of a Notice of Exercising Power of Sale | | One month after delivery of the Notice of Exercising Power of Sale to all affected or persons registered on the title | Starts as part of the main action |
| New Brunswick | Property Act | Rarely used as not included in 1982 Rules of Civil Procedure | Primary | Typically by optional Demand Notice to the borrower followed by required Notice of Sale | | After borrower is 3 months in arrears, they no longer have the right to "reinstate" | Cannot start until after the property has been sold |
| Newfoundland | Conveyancing Act | Rarely used | Primary | Notice to the borrower and current owner | | No right to "reinstate" | Cannot start until after the property has been sold |
| Nova Scotia | | Mortgage Foreclosure | | Lawsuit filed against owner | | At the time that lender applies for Order of Foreclosures, Sale and Possession | Starts as part of the main action |
| Ontario | Ontario Mortgages Act | Rarely used | Primary | Notice of Sale under Mortgage sent to the borrower and current owner | | 35 days after Notice of Sale Under Mortgage if contractual; 45 days after Notice of Sale Under Mortgage if statutory | Cannot start until after the property has been sold |
| Prince Edward Island | Real Property Act | | Primary | Notice to the borrower and current owner | | Prior to date specified in initial notice to buyer customarily after 3 months in default | Cannot start until after the property has been sold |
| Quebec | Details not available | Primary | | Details not available | Details not available | Details not available | Starts as part of the main action |
| Saskatchewan | | Primary | | Lawsuit filed against owner | | | Starts as part of the main action |